82-2071

No.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

LEO A. DREY and KAY K. DREY, his wife

v.

UNITED STATES OF AMERICA

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTION PRESENTED

Whether in a suit for refund of income taxes, where it is shown that the government had made its assessment of deficiency without any minimal evidentiary foundation, the taxpayer has thereby satisfied his burden of proving the assessment to be arbitrary and erroneous; or whether such "naked" and unexplained assessment is to be presumed correct.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

No.

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LEO A. DREY and KAY K. DREY, his wife

v.

UNITED STATES OF AMERICA

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Petitioners respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit entered in this matter on February 24, 1983.

OPINIONS BELOW

The opinion of the Court of Appeals, whose judgment is herein sought to be reviewed, is reported at 83-1 U.S.T.C. ¶ 9219 (8th Cir. 1983) and is reprinted in the Appendix to this Petition. The prior order and opinion of the United States District Court for the Eastern District of Missouri, also reprinted in the Appendix, is reported at 535 F. Supp. 287 (E.D. Mo. 1982).

JURISDICTION

The judgment of the Court of Appeals was entered February 24, 1983. A timely petition for rehearing was denied on March 23, 1983. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. Section 1254(1).

STATUTES AND REGULATIONS

Internal Revenue Code of 1954, 76 U.S.C. Section 170

Internal Revenue Code of 1954, 26 U.S.C. Section 6201

Internal Revenue Code of 1954, 26 U.S.C. Section 6203

Treasury Regulations § 1,170A-1

Treasury Regulations § 301.6201-1

The foregoing are reprinted in the appendix hereto,

STATEMENT OF THE CASE

This income tax refund suit was brought by Petitioners Leo A. Drey and Kay K. Drey, his wife, pursuant to 26 U.S.C. Section 7422 on May 6, 1981.

The Evidence

Prior to 1974, Petitioners owned twenty-six non-contiguous tracts of land, each fronting on either the Current River or the Jacks Fork River in the southeastern Missouri Ozarks (Stip. Exh. 1 and 2). The riverfront portions of Petitioners' lands were all within the boundaries of the Ozark National Scenic Riverways, established in 1964 under Public-Law 88-492 (Stip. 4). In 1970, after solicitation by the National Park Service, Petitioners entered into an Exchange Scenic Easement Deed under which the Park Service conveyed other lands to Petitioners and Petitioners imposed a scenic easement on the 300-foot strip of land contiguous to the low water mark of the river bank in each of

the twenty-six parcels totaling 961.47 acres (T. 7-8, Stip. Exh. 3). Petitioners retained the fee on each parcel as well as the unencumbered fee on the contiguous land abutting each parcel. The pertinent terms of the scenic easement are recited in the opinion of the District Court at pages A-10 through A-11. *Inter alia,* the easement restricted Petitioners from construction, improvement, dumping of rubbish or commercial activity on the encumbered strips of land. Petitioners retained, however, the right to use the scenic easement land for timber harvesting subject to Park Service approval.

One of Petitioners' tracts, located on the right bank descending of the Current River in Section 35, Township 30 North, Range 4 West, contained an unusual stand of virgin white oak trees whose wood was suitable for veneer uses (T. 101-08, Stip. Exh. 1, tract 451-2). These trees, at least fifteen in number, are at least 43 inches in diameter and stand 34 feet or higher to the first limb (T. 102-04). The remainder of the timber on Petitioners' tracts was second growth mixed hardwood suitable only for cooperage and saw log uses.

On June 28, 1974, Petitioners executed and delivered to a charitable foundation a quitclaim deed by which they conveyed all their "right or title" to the twenty-six tracts encumbered by the scenic easement (Stip. Exh. 4). There is no dispute about the deductibility of the value of the interest contributed by Petitioners.

Upon audit of Petitioners' income tax liabilities for 1974, the government challenged the deduction of $275,000 claimed by Petitioners for their contribution of these tracts. Petitioners' deduction was based on appraisal of the loss in value to Petitioners' entire holdings resulting from the severance of the scenic easement land from the backland. The government obtained an appraisal of the contributed lands of $130,000 from H.E. Paterson (Stip. Exh. 6, pp. 7-14). Paterson reviewed the appraisals previously prepared on behalf of Petitioners but made no other observation or study of the land (*Id.*). Before

trial the government employed a second appraiser, Joseph Wildt, who visited eight of the twenty-six tracts and considered the remaining eighteen solely on the basis of aerial photographs (T. 135). Apart from owning certain woodland, this appraiser had no experience as a forester or logger (T. 134). Wildt did not ask Petitioners or their foresters to accompany him on his inspection. He did not recall visiting the tract in Section 35, Township 30 North, Range 4 West and admitted that he had not seen the stand of mature veneer-quality white oak trees on that tract (T. 135).

Wildt appraised the contributed properties on the theory that their highest and best use is timber management,[1] a proposition impliedly accepted in the holdings of the court below. Wildt testified that the value of mixed hardwood timber was $36.50 per thousand board feet in 1974. Based on his interviews with persons said to be knowledgeable about timber, Wildt estimated that the average quantity of merchantable timber in the area of the subject properties is 2,000 board feet per acre (T. 129-30). Using these data, he computed the 1974 gross market value of the standing timber on twenty-five of the contributed tracts at $70,187.31 (*Id.*). On account of the limitation on timber harvesting activity of Park Service consent under the scenic easement deed, as well as the supposed difficulty of access and the scattered locaiton of the tracts, Wildt reduced that value by an arbitrary factor of 45%, to $38,500 (T. 130-31). Adding to that figure the agreed value of $7,000 for the schoolhouse tract, he appraised the contributed lands at total value of $45,500 (T. 131). Wildt included nothing in this figure for the residual value of the land itself for timber purposes, appraising only the value of the crop of timber standing in 1974 (T. 134).

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[1] Apart from one tract containing a disused schoolhouse whose maintenance is permitted under the scenic easement and upon whose value for recreational uses the parties agreed.

Being unaware of the virgin white oak stand, Wildt assumed that the only timber on the contributed lands was mixed hardwoods and included nothing for veneer-quality timber in his appraisals.

Charles Kirk, a forestry consultant, testified on behalf of Petitioners on the subject of timber valuation. Kirk had been a forester for Petitioner Leo Drey and had been closely involved in the management of the twenty-six subject tracts over a period of more than twenty-five years. Kirk testified that in 1974 the markets for mixed hardwoods were of three types, depending on the quality of the wood: veneer at $1,400 per thousand board feet, cooperage at $350 per thousand board feet, and saw logs at $40 per thousand board feet. Apart from the stand of mature white oaks in Section 35, Township 30 North, Range 4 West, Kirk appraised the 1974 gross value of the timber standing on the twenty-five tracts (other than the schoolhouse parcel) at $72,000, close to Wildt's figure of $70,187.31 (T. 103-04, 130-34).

Kirk also took into account the veneer-quality white oaks. These trees were appraised at $70,000 based on their age and dimensions (T. 135). The best tree taken from a cut of ten dead trees at this location (made after 1970 and with Park Service permission) brought $3,200 by itself at a sale (T. 109-10). Kirk further concluded that the land has value as timber land in excess of the value of the present crop of timber standing on it (T. 106-07). Kirk applied no discount to his aggregate gross value of $142,000, due to the feasibility of access to the tracts for experienced loggers and the suitability of the tracts for logging in conjunction with Petitioners' contiguous unencumbered tracts (T. 105, 109).

The Internal Revenue Service, however, made an assessment of tax based on valuation of the twenty-six contributed parcels at a total of $45,500 (Stip. 8, Stip. Exh. 1). Pursuant to this determination, and other adjustments not at issue here, the Service assessed against Petitioners the amount of $160,650 in tax.

plus interest (Trial Ct. Finding 8). After disallowance of their claim for refund, Petitioners filed timely suit for refund (Finding 9).

The Rulings Below

The lower courts both held that Petitioners' appraisal evidence - consisting principally of before-and-after appraisals reflecting loss of recreational use value to Petitioners' entire holdings resulting from the severance - failed to meet their burden of proving the assessment erroneous. The lower courts reasoned simply that the value of the property contributed to charity is determined by what is contributed and not by severance damages to adjoining land.

A second basis of valuation at issue was the usefulness of the contributed land for timber management. The opinion of the District Court dealt with timber valuation only in terms of Wildt's evidence. Petitioners' evidence was discussed only insofar as it dealt with issues of valuation of the subject properties for recreational purposes.

The opinion of the Eighth Circuit Court of Appeals omitted as well any mention of Petitioners' timber valuation evidence. Neither opinion took into consideration the existence of the mature white oak stand in Section 35, and neither addressed the procedural issues concerning the naked assessment of value by the Service with respect to that parcel presented by Petitioners on brief and in oral argument.

REASONS FOR GRANTING THE WRIT

This Court should grant certiorari in order to maintain uniformity in the law and to resolve a conflict in principle between two appellate circuits.

Sub silentio, the courts below have held that an assessment of value by the Internal Revenue Service of property contributed to charity is valid even where that assessment is made without even a minimal evidentiary foundation, without any explanation of the assertion set forth in the assessment, and in disregard of the duty of the service to make a good-faith appraisal of value of each contributed property whose valuation is disputed by the assessment. In other words, the lower courts have held in this case that a naked assessment, unsupported by any allegation of error on the taxpayers' part, is entitled to enjoy a presumption of correctness. Such a procedure is properly forbidden by the Court of Appeals for the Sixth Circuit.

As to Valuation for Timber Management

Let us assume *arguendo* that timber rather than recreation was the highest and best use of the lands in question, and that severance damages to retained property are to be excluded in valuing contributed property (issues which preoccupy the opinions of the lower courts). Assume that no question is raised as to the twenty-five tracts which have no veneer timber. The issue remains as to the appraisal of the value of the mature white oak trees in Section 35 in which the government's assessment entirely disregarded the suitability of that timber for veneer uses and was based on no evidence whatever as to that particular stand of timber. With respect to this timber stand - whose $70,000 appraised value is substantial - the government relies on a bare assessment, unsupported by any allegation of error in the return as originally reported by the taxpayers.

It is familiar law that in the usual situation the assessment of a deficiency by the Commissioner of Internal Revenue is presum-

ed to be correct and the taxpayer carries the burden of proof to overcome that presumption. *Welch* v. *Helvering,* 290 U.S. 111, 115 (1933); *United States* v. *Janis,* 428 U.S. 433, 441 (1976). Furthermore, in a suit for refund of taxes in district court the taxpayer is required to show not only that the assessment was erroneous but also the amount which he is entitled to recover. *Helvering* v. *Taylor,* 293 U.S. 507 (1935). Petitioners do not challenge these general rules, but rather maintain their settled application to the unusual case of a "naked" arbutrary assessment. Where the government fails to provide a minimal evidentiary foundation to show that the assessment was not mistakenly or irrationally made, the burden of proof of the allegation reflected in the assessment remains with the government. "Certainly proof that an assessment is utterly without foundation is proof that it is arbitrary and erroneous.... The determination of the tax then due may be one 'without rational foundation and excessive' and not properly subject to the usual rule with respect to burden of proof. [Citation omitted]" *United States* v. *Janis,* 428 U.S. 433, 442 (1970). An assessment without evidentiary basis is not a "regular" assessment, and the payment of an irregular assessment is an over-payment recoverable on proof of irregularity alone. *Id.*

In this instance, the government presented no evidence of - and confessed its entire ignorance concerning - the mature white oak stand in Section 35. The government is presumed to have presented any evidence which it had to sustain the assessment, which is itself a bookkeeping entry reflecting unspecified underlying factual allegations. The uncontradicted testimony of Kirk was that the contributed properties had a value of $140,000, taking into account that mature timber. Yet the lower courts have sustained an unsupported valuation of only the immature portion of the standing timber.

The refusal by the government to address this evidence and the neglect of the lower courts to speak to this issue raise policy issues of importance. As the Sixth Circuit Court of Appeals

said, correctly we submit, in *Coleman* v. *United States*, ____ F.2d ____ (6th Cir. 1983), 83-1 U.S.T.C. ¶ 9288:

> ... the precise holding of *Janis* does not create an "exception" to the usual burden upon the taxpayer; rather it teaches that the burden is met when the assessment is shown to be more than merely erroneous; that is, an assessment is *per se* arbitrary and unenforceable when it is established that it is "naked" and "utterly without [evidentiary] foundation."

In *Coleman*, where the government admitted that it had no work papers, records or other explanation of its assessment, the Sixth Circuit squarely held that the taxpayers, in their suit for refund of taxes collected, had "satisfied their burden of proving that the assessment is arbitrary and so cannot be enforced." *Id.* The Sixth Circuit Court rejected squarely the government contention that mere entry of an assessment casts the burden of proof on the taxpayer where the assessment is naked and unexplained.

The government has failed to comply with the mandate of Treas. Reg. § 301.6201-1(a) that

> The district director is authorized and required to make all inquiries necessary to the determination and assessment of all taxes imposed by the Internal Revenue Code of 1954 or any other internal revenue law.

as well as the general statutory mandate of 26 U.S.C. Section 6201:

> The Secretary is authorized and required to make the inquiries, determinations, and assessments of all taxes ... imposed by the title.

An assessment made without "all inquiries necessary" into the pertinent facts is thus unlawful as well as arbitrary.

The instant case, as to the Section 35 mature timber stand, falls squarely within the factual pattern of *Coleman*. The government's refusal to appraise the value of veneer-quality timber remains wholly unexplained. The courts below erroneously accepted the bald assertion of the assessment as effective to raise a presumption of the value of that timber as virtually worthless when that assessment is unsupported by any minimal evidentiary basis. The lower courts compounded that error by disregarding without notice or comment the uncontradicted evidence of specific factual basis for the opinion of Kirk as to the value of mature timber. The testimony of a witness on behalf of the taxpayer negating the factual assertions of an unsupported assessment "destroyed any presumption of correctness of the commissioner's determination. It therefore became the duty of the government affirmatively to prove its case." *Weir* v. *Commissioner,* 283 F.2d 675, 682 (1960). Under *Janis* and *Coleman,* the same sound principle applies to refund suits. Finally, the courts below swept the entire issue under the rug by omitting discussion of the procedural issue raised by such an assessment.

As to Recreational Use

The issues principally argued by the parties below and entirely preempting the opinions of the lower courts concerned valuation of the contributed properties for recreational use. Petitioners' expert real estate appraisers, Tom McReynolds and Stephen Thornton, determined that the highest and best use of Plaintiffs' entire holding (comprising the encumbered fee interest in the 300-foot riverfront strips under the scenic easement and the unencumbered contiguous backland) prior to the 1974 conveyance to charity of the riverfront land was recreation (T. 41). So long as both the riverfront and backland parcels remained under unified ownership, the backland owner would enjoy assured access to the river, and the most remunerative use of the 300-foot scenic easement strip would be for recreational development in conjunction with the backland (T. 49, 78, 84). Petitioners therefore claimed as a deduction the loss in value of

$275,000 resulting to their entire holdings from the severance of their scenic easement fee interest from the unencumbered contiguous lands and the attendant loss of suitability of those backlands for development (T. 41, 60-61, 47-48, 86-87). Petitioners' appraisers, McReynolds and Thornton, considered the adaptability of the contributed scenic easement parcels for use in conjunction with the retained backland as their chief element of value (T. 49-50, 60-61, 95-97).

The government and its appraiser, Wildt, proceeded on the basis that these elements of value in the contributed parcels were merely "severance damages" to retained property. Wildt stated flatly that he considered no market data with respect to the backlands, either before or after the 1974 severance (T. 135-37) and that he considered before-and-after appraisal inappropriate (T. 152-53). The government and the courts below adopted Wildt's characterization of the separate sale value of the 300-foot strip in isolation from adjoining property as "the property contributed." From this facile premise, they allocated the entire assemblage value of the original tract to the category of damages to remaining property and therefore not allowable as a deduction.

This semantic argument obscures the bald refusal of the government to appraise those elements of value in the contributed property which have significance. Even though Wildt observed certain parcels and testified to his conclusions from such observations, he admittedly averted his eyes from the backlands and from the fall in value to Petitioners' holdings which was inherent in their charitable contribution. Location is necessarily a determinant of land values. Such an arbitrary refusal to value the pertinent elements of value in the land contributed by Petitioners amounts to a naked and unexplained assessment, as fatally defective with respect to the remaining twenty-five parcels as was Wildt's failure to value veneer timber on the twenty-sixth.

The government and the lower courts had no basis for reducing the valuation of the contributed parcels except the untenable conclusions of Wildt's appraisal, fully recited in his testimony. The case therefore presents once again the issue of a naked assessment, rejecting any consideration of pertinent facts, with respect to all parcels at issue.

The Conflict in Principle Between Circuit Courts

As an exercise of its supervisory power, enforcing the rule of *Janis,* and in order to resolve a conflict in principle among the Circuit Courts of Appeal as to the application of *Janis* to suits for refund, this Court should grant certiorari. Although the Eighth Circuit Court of Appeals did not expressly pass on the procedural issue, it could not have affirmed the decision below without resolving against Petitioners the question whether a naked assessment is enforceable in a tax refund suit. This holding squarely contradicts *Coleman,* offends fundamental concepts of fairness, and invites arbitrary and abusive action by the Revenue Service.

CONCLUSION

WHEREFORE, Petitioners pray that a writ of certiorari be granted.

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APPENDIX

APPENDIX A

Internal Revenue Code of 1954 (26 U.S.C.)

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) Allowance of Deduction.—

(1) General Rule.—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.

* * * * *

(c) Charitable Contribution Defined.—For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of—

* * * * *

(2) A corporation, trust, or community chest, fund, or foundation—

* * * * *

(B) organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, ***.

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

* * * * *

SEC. 6201. ASSESSMENT AUTHORITY.

The Secretary is authorized and required to make the inquiries, determinations, and assessments of all taxes ... imposed by this title.

* * * * *

SEC. 6203. METHOD OF ASSESSMENT.

The assessment shall be made by recording the liability of the taxpayer in the office of the Secretary in accordance with rules or regulations prescribed by the Secretary. Upon request of the taxpayer, the Secretary shall furnish the taxpayer a copy of the record of the assessment.

* * * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.)

§ 1.170A-1. Charitable, etc., contributions and gifts; allowance of deduction.

* * * * *

(c) Value of a contribution in property. (1) If a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the propety at the time of the contribution reduced as provided in section 170(e)(1) and paragraph (a) of § 1.170A-4.

* * * * *

(2) The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both have no reasonable knowledge of relevant facts. ***

* * * * *

§ 301.6201-1(a). Assessment Authority

The district director is authorized and required to make all inquiries necessary to the determination and assessment of all taxes imposed by the Internal Revenue Code of 1954 or any other internal revenue law.

* * * * *

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 82-1627

Leo A. Drey, Kay K. Drey,
Appellants,

v.

United States of America,
Appellee.

Appeal from the United
States District Court
for the Eastern District
of Missouri

Submitted: February 14, 1983

Filed: February 24, 1983

Before HEANEY, McMILLIAN and ARNOLD,
Circuit Judges.

PER CURIAM.

Taxpayers Leo A. Drey and his wife, Kay K. Drey, appeal from a final judgment entered in the District Court[1] for the

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[1] The Honorable John F. Nangle, United States District Judge for the Eastern District of Missouri.

Eastern District of Missouri denying their claim against the United States for refund of additional tax and interest paid pursuant to an Internal Revenue Service (IRS) deficiency assessment. For reversal the taxpayers argue that the IRS undervalued certain real property donated by the taxpayers for purposes of a charitable contribution deduction with respect to their 1974 income tax. For the reasons discussed below, we affirm the judgment of the district court.

On June 28, 1974, the taxpayers executed and delivered to the L-A-D Foundation, Inc. a quit claim deed by which the taxpayers conveyed their interest in 961.47 acres of river front land subject to a scenic easement previously conveyed to the United States pursuant to an Exchange Scenic Easement Deed. The L-A-D Foundation, Inc. was then an organization organized exclusively (by the taxpayers) for public and charitable purposes within the terms of § 170(c)(1) of the Internal Revenue Code. 26 U.S.C. § 170. The taxpayers claimed a charitable deduction of $275,000.00 on their 1974 personal income tax return for the value of this property conveyed to L-A-D Foundation, Inc.

The taxpayers claimed that lands owned by them contiguous to the donated strip of river front land were best suited for recreational development. They also claimed that their contiguous land was reduced in value by $275,000.00 because of diminished access[2] to the river resulting from the charitable

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[2] In fact, however, by the terms of the Scenic Easement Deed the owner of the donated fee is restricted from "[p]rohibiting ingress and egress over and across and use by the general public of any or all of the herein described lands." *Drey* v. *United States*, No. 81-521C(2), slip op. at 3 (E.D. Mo. Mar. 31, 1982).

donation of the fee underlying the scenic easement. The Commissioner determined that the fair market value[1] of the property contributed to the L-A-D Foundation, Inc. was $45,500.00.

The taxpayers asserted the rules for determining fair market value in income tax cases and condemnation cases are the same. The standard for valuing property taken for public use in an eminent domain proceeding "consists not only in an award of the value of lands which are taken, but also of any damage that may result to the portion of the tract which remains." *Sharp* v. *United States,* 191 U.S. 341, 351-52 (1903).

We agree with the district court's reasoning that the measure of compensation for property donated as a charitable contribution is statutory and not the same substantial right protected by the fifth amendment of the Constitution in condemnation cases. Condemnation proceedings usually require a "taking" which require a property owner to part with his property involuntarily. The same considerations are not present where a taxpayer makes a voluntary decision to donate property to charity. Therefore, the district court properly decided that the value of the taxpayers' charitable contribution must be determined by the value of the property donated and not by severance damages to the adjacent land.

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[1] The Internal Revenue Code provides that "there shall be allowed as a deduction any charitable contribution . . . payment of which is made within the taxable year." 26 U.S.C. § 170(a)(1). The Treasury regulations state that where, as here, "a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution." Treas. Reg. § 1.170A-1)c)(1) (1982). The phrase "fair market value" is defined as the "price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." *Id.* § 1.170A-(c)(2); *accord, Fitts' Estate* v. *Commissioner,* 237 F.2d 729 (8th Cir. 1956). It is evident that neither of the values relied upon by the parties permit the ready application of the willing seller/willing buyer test.

Accordingly, the judgment of the district court is affirmed.

A true copy.

ATTEST:

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT

APPENDIX C

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

No. 81-521 C (2)

Leo A. Drey and Kay K. Drey,
Plaintiffs,

v.

The United States of America,
Defendant.

MEMORANDUM

(Filed in U.S. District Court on March 31, 1982)

Plaintiffs Leo A. Drey and Kay K. Drey brought this cause of action pursuant to 28 U.S.C. §1346(a)(1). Plaintiffs instituted this suit against the United States after the Internal Revenue Service denied their claim for a refund of taxes and interest, which they claim were erroneously assessed and collected by the defendant. Plaintiffs allege that they are entitled to a refund because the Internal Revenue Service failed to consider the loss in value to their adjoining property when the agency calculated the fair market value of the property which the plaintiffs donated to the L-A-D Foundation, Inc. and claimed as a charitable contribution deduction pursuant to Section 170(c)(1) of the Internal Revenue Code.

This case was tried to the Court sitting without a jury. The Court having considered the pleadings, the testimony of the witnesses, the documents in evidence and the stipulations of the [2] parties, and being fully advised in the premises, hereby makes the following findings of fact and conclusions of law, as required by Rule 52 of the Federal Rules of Civil Procedure.

FINDINGS OF FACT

1. Plaintiffs Leo A. Drey and Kay K. Drey, his wife, are citizens of the United States and residents of St. Louis County, Missouri.

2. Prior to July of 1970, plaintiffs acquired 26 non-contiguous tracts of riverfront land in southeastern Missouri, scattered along both banks of the Current and Jacks Fork Rivers; 25 of these tracts are situated in Shannon County and 1 in Carter County, Missouri.

3. Plaintiffs' tracts extended various distances from either of the ordinary low water marks, or banks of the rivers, but in no case less than 800 feet.

4. The tracts were wooded and unimproved except for 1 abandoned schoolhouse and various roads and trails.

5. On July 23, 1970 plaintiffs executed and delivered to the United States an Exchange Scenic Easement Deed. The property affected by the easement was 961.47 acres of riverfront land, consisting of the 300 foot strip of land contiguous to the low water mark of the river bank in each of the 26 parcels. The deed imposed restrictions upon the land and required the landowners to refrain from certain activities. The plaintiffs retained the fee on the 961.47 acres as well as the unencumbered [3] fee on contiguous parcels. The terms of the Scenic Easement Deed are as follows:

> WHEREAS, pursuant to the authority contained in an act of Congress enacted August 27, 1964, Public Law 88-492, the parties hereto have agreed to an exchange of lands located within the authorized boundaries of the Ozark National Scenic Riverways, for land of approximately equal value which lies outside the boundaries, but excess to the requirements thereof.

* * * * * * * * * * * *

The scenic easement restrictions hereby imposed upon the use of said lands and the acts which the parties of the first part so covenant to refrain from doing upon the said hereinafter described lands are and shall be as follows:

1. Prohibiting ingress and egress over and across and use by the general public of any or all of the herein-described lands***for such purposes as are not inconsistent with the restrictions and purposes of said scenic easement.

2. Using the said lands for mining or industrial activity or for any purposes whatsoever except for non-commercial residential purposes or for such additional purposes as may be authorized in writing on such terms and conditions deemed appropriate by the Secretary of the Interior or his authorized representative. But the parties of the first part shall not be precluded hereby from farming the land nor from grazing livestock thereon provided the same be done in conformity with good husbandry practice. The permitted use for farming and grazing shall include the harvesting of timber, and gathering firewood for personal use but only from selected areas which the Park Superintendent may approve.

3. Erecting or building any structures on said lands, including major alterations to existing buildings, except as may be authorized in writing by the Secretary of the Interior or his duly authorized representative.***

4. Permitting any change in the character of the topography of said lands other than that caused by the forces of nature. ...

5. Permitting the accumulation of any trash or foreign material which is unsightly or offensive.

6. Cutting or permitting to be cut, destroying, or [4] removing any timber or brush, except as may be authorized in writing by the Secretary of the Interior or his duly

authorized representative. Provided, however, that seedling trees or seedling shrubbery may be grubbed up .... [for] good farm practice on lands presently being cultivated or for residential maintenance purposes....

7. No trailer shall be placed, used or maintained on said lands as a substitute for a residential building or other structure, and no sign, billboard, or advertisement shall be displayed or placed upon the land....

By acceptance of this deed, the party of the second part specifically agrees for the purpose of the parties of the first part retaining their present means and rights of ingress and egress, that the parties of the first part, their heirs, successors and assigns, or invitees, shall not be required to pay, when proceeding directly to and from such lands, park entrance or road fees.

6. On June 28, 1974, plaintiffs executed and delivered to the L-A-D Foundation, Inc. a quitclaim deed by which plaintiffs conveyed "any right or title" in the 300 foot strip of property encumbered by the scenic easement. The L-A-D Foundation, Inc. was then an organization organized exclusively for public and charitable purposes within the terms of Section 170(c)(1) of the Internal Revenue Code.

7. Plaintiffs filed their 1974 personal income tax return and claimed thereon a charitable contribution deduction of $275,000.00 for the value of the property which they conveyed by quitclaim deed to the L-A-D Foundation, Inc.

8. Upon audit of plaintiffs' income tax liabilities for 1974, the Internal Revenue Service determined that the fair market value of the property contributed to the L-A-D Foundation, Inc. was $45,500.00. Pursuant to this determination, and other adjustments which are not at issue here, the Internal [5] Revenue Service assessed against plaintiffs the amount of $160,650.00 in additional income taxes, plus statutory interest of $57,804.29. Plaintiffs paid these additional amounts on May 27, 1980.

9. On September 12, plaintiffs filed a timely claim for refund of the additional tax and interest, alleging that the property had been erroneously assessed and the taxes and interest erroneously collected. The Internal Revenue Service disallowed the claim for a refund on February 12, 1981. Plaintiffs thereafter timely instituted this action.

10. At trial the two experts who had initially appraised plaintiffs' property at $280,000.00 and $270,000.00 testified as to their methods of valuation of the fee underlying the scenic easement. Plaintiffs' appraisers McReynolds and Thornton used a "before-and-after" approach on the theory that sales of this nature do not occur in the market between knowledgeable parties. Plaintiffs' experts testified that the highest and best use of the adjoining properties retained by the plaintiffs prior to 1974 was wilderness recreation development on a low density basis. These contiguous properties comprise 1,602.45 acres and were readily suitable for subdivision into at least 240 lots for recreational and vacation cabins. McReynolds and Thornton testified that the market value of these adjoining properties and their use for recreational purposes was dependent upon the owner of these properties having title to the fee underlying [6] the scenic easement which in turn assured access to the river. Therefore, the appraisals of plaintiffs' contiguous parcels of properties resulting from the donation of the fee underlying the scenic easement and the loss of access to the river. The experts concluded that the value of plaintiffs' contiguous property was significantly reduced in the amounts of $280,000.00 and $270,000.00 respectively. The experts also testified that the value of the fee underlying the scenic easement was minimal; the parcel of land with the old school house had a value of $6,000.00 to $7,000.00.

11. Defendant supported its determination of the fair market value of the scenic easement land by presenting the expert testimony of Joseph Wildt of the Internal Revenue Service. Wildt testified that the only profitable use of the property

underlying the scenic easement was in timber operations because of the restrictions and prohibitions imposed upon the use of the land by the terms of the scenic easement. Wildt determined the total value of the standing timber by estimating the board feet of timber per acre and obtaining comparable sales of timber in the area during 1974. From that value Wildt discounted the total value of the timber by 45% because of the difficulty of access, the small size of the parcels, and the terms of the Exchange Scenic Easement Deed which required the owner of the fee to acquire Park Service approval for timber harvesting under [7] paragraph 2 of the deed. Finally, Wildt evaluated the tract upon which the school house was located at $7,000.00 and added this amount to the value of the timberland to reach a total fair market value of the scenic easement land of $45,000.00. Wildt testified that he did not appraise the value of the adjoining strips of retained land because the plaintiffs had not contributed this land and because severance damages were not an appropriate consideration in an appraisal of land for income tax purposes.

CONCLUSIONS OF LAW

This Court has jurisdiction of this case pursuant to 28 U.S.C. §1346(a)(1). Plaintiffs claim that they are entitled to a refund of federal income taxes because the Internal Revenue Service failed to include severance damages in its appraisal of the property donated to the L-A-D Foundation, Inc. and claimed as a charitable deduction by plaintiffs. Therefore, the question of law presented by this case is whether the reduction in value to adjoining properties is an appropriate consideration when calculating the fair market value of properties claimed as deductions.

Section 170 of the Internal Revenue Code provides for a deduction for contributions and gifts to or for the use of organizations described in Section 170(c).[1] In 1974 plaintiffs [8]

[1] Section 170(c) is subject to various limitations which are not relevant to this cause of action.

donated their fee underlying the scenic easement to the L-A-D Foundation, Inc.; the foundation was an "organization" as that term is defined within Section 170(c). See Findings of Fact Nos. 6-7. For purposes of determining the amount of a charitable deduction the Code further provides that if a charitable contribution is made in property other than money, the amount of the charitable deduction is the fair market value of the property at the time of the contribution. The fair market value is the price at which property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. Treasury Regulations on Income Tax (1954 Code (26 C.F.R.), 1.170A-1(c); Revenue Ruling 76-376, 1976-2 Cum. Bull. 53; *Fitt's Estate* v. *Commissioner*, 237 F.2d 729 (8th Cir. 1956). It is evident that this general standard does not resolve the question of whether gain or loss to adjoining retained property should be considered when determining the fair market value of property claimed as a charitable deduction under Section 170(c) of the Internal Revenue Code.[2]

In an effort to support their contention that severance damages are an essential component for the fair market value of [9] property contributed as a charitable deduction, plaintiffs assert that the rule for condemnation cases and income tax cases are the same. The standard for valuing property taken for public use or condemnation "consists not only in an award of the value of lands which are taken, but also of any damages that

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[2] It is evident that neither of the values estimated by the parties in this action would allow for a mutually willing buyer and seller. The taxpayers would have been unable to find a willing buyer at the price determined by their appraisal of the fair market value of the fee underlying the scenic easement; and the taxpayers would not have been willing to sell the property at the price set by the Internal Revenue Service.

may result to the portion of the tract which remains..." *Sharp* v. *United States,* 191 U.S. 341, 351-52 (1903). In order to comply with the requirement of just compensation embodied in the Fifth Amendment of the Constitution, courts have had to adopt working rules in order to do substantial justice in eminent domain proceedings. *United States* v. *Miller,* 317 U.S. 369, 375 (1943). However, severance damages become an essential element of properties taken for purposes of condemnation only if the government takes a portion of a parcel of land which has been used and treated as an entity. 317 U.S. at 376. Therefore, it is clear that the Constitution has never been construed to require payment of "consequential damages" whenever the government takes a separate tract of the owner in eminent domain proceedings. *Id.*

It is evident that severance damages are not always an element of the fair market value of properties taken in condemnation proceedings. *United States* v. *Miller, supra; Sharp* v. *United States, supra.* Therefore, there is validity to the proposition presented by the defendant that severance damages to remaining property are added to the fair market **[10]** value of the property taken for the purpose of reaching just condemnation under the Fifth Amendment in condemnation cases.[3] More im-

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[3] The government also argues that Revenue Ruling 76-376, 1976-2 Cum. Bull. 53 supports the proposition that when determining the fair market value of property contributed for purposes of charitable deduction, gain or loss to adjoining retained property is never considered. Although the Internal Revenue Service did not look at the detriment to the retained 2 acres when valuing the 8 acres for purpose of charitable contribution deduction, it is not clear that the issue of severance damages was before the agency at this time. Therefore, the Court cannot accept the argument that this Revenue Ruling conclusively demonstrates that severance damages is not a valid consideration when valuing property contributed pursuant to Section 170 of the Internal Revenue Code.

portantly, the assessment of the fair market value of property in condemnation proceedings involves certain considerations that are not necessarily present when valuing property donated and claimed as a charitable deduction. The measure of compensation in condemnation proceedings is a substantial right guaranteed by the Constitution of the United States. *United States* v. *Miller, supra.* In addition, the concept of just compensation requires that "no private property [may] be appropriated to public uses unless a full and exact equivalent for it be returned to the owner." *Olson* v. *United States,* 292 U.S. 246, 254. Finally, condemnation proceedings involve a "taking" which often require a property owner to part with his property involuntarily. None of these considerations is present under the facts of this case. Therefore this Court is unable to accept the proposition that the method of valuing the fair market value of property in condemnation proceedings is the same as the **[11]** method of valuing property claimed as a charitable deduction.[4]

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[4] This Court takes note of the fact that plaintiffs find some support of the proposition that the rule of valuation for income tax purposes is the same as the rule in condemnation proceedings in *Benjamin Klopp,* 19 TCM 973 (1960). In that case the court held: "in determining the fair market value of that portion of petitioner's property which was contributed under threat of condemnation to the United States, so-called 'seveance damages' to adjacent property retained by plaintiff are an intrinsic and integral part of the fair market value of the property contributed." 19 TMC at 977. However, this case may be distinguished from the facts of the case at bar on the grounds that the property "was contributed under threat of condemnation." Therefore the considerations present in condemnation proceedings were of concern in this case; the taxpayer was threatened with the loss of his property to the United States. Rather than lose his property to the government in condemnation proceedings he chose to give it as a charitable contribution.

There is also dicta in this decision which suggests that the fair market value is constant and does not vary according to whether the taxpayer is seeking a charitable deduction or just compensation for property condemned. 19 TCM at 977. In view of the fact that this Court believes that it is free to examine purpose when determining the fair market value of property it must reject dicta to the contrary contained in *Benjamin Klopp, supra.*

This Court believes it is free to examine the purpose when determining the fair market value of property donated or condemned. The Supreme Court recognized the problem in valuing property which has no real market: "[w]hen, for any reason, property has no market value, resort must be had to other data to ascertain its value; and, even in the ordinary case, assessment of market value involves the use of assumptions, which make it unlikely that the appraisal will reflect the value with nicety." *United States* v. *Miller,* 317 U.S. at 374.

It is clear that the concept of just compensation and **[12]** and the Fifth Amendment require the government to fully compensate the seller for any detriment that has been suffered. Therefore the payment of severance damages will be a valid consideration in condemnation proceedings. However, the value of property donated as a charitable contribution should be evaluated by determining the fair market value of the property donated by the taxpayer to the charitable organization.

Under the circumstances of this case, plaintiffs freely chose to donate their property to the L-A-D Foundation by executing a quitclaim deed by which plaintiffs conveyed "any right or title" in the 300 foot strip of property encumbered by the scenic easement.[5] Therefore, the considerations that arise in condemnation proceedings when assessing the fair market value of property taken by the government, do not arise under the facts of this case. The measure of compensation is not a substantial right guaranteed by the Constitution when property is donated as a charitable contribution. Therefore, this court believes that it is free to assess the fair market value of the land donated by the

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[5] This court would observe in passing that the L-A-D Foundation is a charity founded by the plaintiffs. Therefore it is unclear whether the plaintiffs might exercise any control over this property, as founders of this charity. However, this court recognizes that under the terms of the quitclaim deed the plaintiffs, as individuals, gave up any legal rights that they had in connection with the fee underlying the scenic easement.

plaintiffs, by determining the value of the property donated by the taxpayer to a charitable organization. Under this standard, severance **[13]** damages are not a valid consideration. Therefore, it is the conclusion of this court that the taxpayers have failed to sustain their burden of showing that the Commissioner's determination is invalid. *Helvering* v. *Taylor,* 293 U.S. 507, 515 (1935).

Accordingly, judgment will be entered for the defendant.

/s/ John F. Nangle

UNITED STATES DISTRICT JUDGE

Dated: March 31, 1982.

Order

(Filed in U. S. District Court on March 31, 1982)

Pursuant to the memorandum filed herein this day,

IT IS HEREBY ORDERED, ADJUDGED and DECREED that the defendant shall have judgment against the plaintiffs.

/s/ John F. Nangle
UNITED STATES DISTRICT
JUDGE

Dated: March 31, 1982.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

September Term 1982

No. 82-1627-EM

Leo A. Drey; Kay K. Drey,
Appellants,

vs.

United States of America,
Appellee.

Appeal from the United States District Court
for the Eastern District of Missouri

Petition of appellants for rehearing filed in this cause having been considered, it is now here ordered by this Court that the same be, and it is hereby, denied.

Marcy [sic] 23, 1983

Office-Supreme Court, U.S.
FILED
AUG 23 1983
ALEXANDER L. STEVAS,
CLERK

No. 82-2071

In the Supreme Court of the United States

OCTOBER TERM, 1983

LEO A. DREY AND KAY K. DREY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

TABLE OF AUTHORITIES

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UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners seek review of the decision of the court of appeals affirming the district court's judgment that they failed to sustain their burden of proof in this tax refund action. At issue is a charitable deduction taken by petitioners under Section 170 of the Internal Revenue Code of 1954, 26 U.S.C. 170, for donating 961.47 acres of real property to a charitable foundation. The Internal Revenue Service determined that the land had a fair market value of $45,000; petitioners claim the value is significantly higher. The taxpayer bears the burden of proving that the Internal Revenue Service assessment is invalid (*Lewis* v. *Reynolds*, 284 U.S. 281 (1932)). The sole issue is a factual one of valuation and does not warrant further review by this Court.

The pertinent facts, as found by the district court (Pet. App. A9-A13), may be summarized as follows: Petitioners Leo A. and Kay K. Drey were the owners of 26 noncontiguous tracts of riverfront property along the banks of the

Current and Jacks Fork Rivers in southeastern Missouri. The tracts, which are at least 800 feet deep, are wooded and unimproved except for one abandoned schoolhouse and various roads and trails. In 1970, petitioners conveyed an Exchange Scenic Easement Deed to the United States under which they retained the underlying fee but granted to the government an easement in each of the 26 tracts running for a distance of 300 feet back from the low water marks of the rivers. Petitioners retained an unrestricted fee interest in all of the upland acreage beyond the 300-foot point. In all, the property covered by the easement consisted of 961.47 acres. By the deed, petitioners covenanted to permit ingress and egress by the general public over the land for any purpose not inconsistent with the easement, and to refrain from construction, improvement, dumping, or commercial or industrial activity on the land.[1] The government agreed to permit petitioners, their heirs, successors, and assigns to retain their rights of ingress and egress over the land (Pet. App. A9-A11).

In 1974, petitioners conveyed their retained fee interest in the 961.47 acres encumbered by the scenic easement to the L-A-D Foundation, Inc.[2] On their income tax return for that year, petitioners claimed a charitable contribution deduction for the transfer in the amount of $275,000. Upon audit, the Internal Revenue Service determined that the fair market value of the property contributed to the L-A-D Foundation was $45,000 and assessed petitioners an additional $160,650 in taxes and $57,804.29 in interest (Pet.

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[1]Petitioners retained the right to harvest timber on the property, subject to approval by the National Park Service (Pet. App. A10).

[2]The L-A-D Foundation, Inc. (the initials of which stand for Leo A. Drey) was organized exclusively for public and charitable purposes within the terms of Section 170(c)(1) of the 1954 Code (Pet. App. A11).

App. A11). Petitioners paid the assessment and brought suit for refund in the United States District Court for the Eastern District of Missouri. Petitioners' two valuation experts testified at trial that the value of the fee underlying the scenic easement was "minimal" (Pet. App. A12). However, they assigned a value to the gift in the respective amounts of $270,000 and $280,000 on the theory that the value of petitioners' retained upland tracts was diminished to that extent by loss of a right of access to the river.

The district court denied petitioners' claim for refund, finding that they had failed to sustain their burden of showing that the Commissioner's determination was incorrect. The court rejected their theory that severance damages to the retained lands should be considered in valuing the donated land (Pet. App. A18). The court of appeals affirmed (*id.* at A4-A7).

1. Petitioners argue (Pet. 10-12), as they did in the court below, that taxpayers may take into account any decrease in the value of contiguous property when computing the fair market value of property donated to charity. Petitioners support this argument by analogy to valuation of property for purposes of compensation under the Takings Clause of the Fifth Amendment. This argument was properly rejected by the courts below.

When property is condemned or otherwise involuntarily taken, the individual is entitled under the Constitution to an award equal to the value of the land taken, as well as an award for any diminution in value that may result to the portion which remains (*Sharp* v. *United States*, 191 U.S. 341, 351-352 (1903)). This principle, however, does not apply to a voluntary donation of land to charity. Condemnation seeks to measure what is *taken from* the property owner; Section 170 seeks to value what is *given to* the transferee. As the court of appeals stated (Pet. App.

A6): "[T]he value of the taxpayers' charitable contribution must be determined by the value of the property donated and not by severance damages to the adjacent land."[3]

In any event, as the court of appeals noted (Pet. App. A5 n.2), petitioners' claim that their access to the river was diminished by the transfer is contradicted by the terms of the scenic easement deed, which guarantees rights of ingress and egress to the general public over the donated lands.[4]

2. Petitioners also contend (Pet. 7-10) that the government failed to provide a minimal evidentiary foundation for its assessment. Citing *United Sates* v. *Janis*, 428 U.S. 433 (1976), they assert that the usual rules placing the burden of proof on the taxpayer in refund suits are not applicable. Petitioners contend that the government presented no evidence to refute certain testimony presented by them that the timber on the land donated to the L-A-D Foundation had a value of $140,000 (Pet. 8). To the contrary, that testimony was contradicted by the government's valuation expert, who testified in detail that the property had a value for

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[3]The same result is reached under an application of Rev. Rul. 76-376, 1976-2 Cum. Bull. 53, which concluded that the value of an open space easement covering part of a tract of land may be computed as the difference in fair market value of the entire tract before and after grant of the easement, and that the value of a subsequent charitable donation of the land encumbered by the easement is the fair market value of the donated land in its encumbered state with no additional allowance for severance damages to retained land. This Revenue Ruling was cited to the court of appeals (Br. for Appellee 2, 17), but was not relied upon in its decision.

[4]Petitioners candidly admitted in their brief in the court of appeals that the "severance damages" they seek are in fact the value of the "leverage" the owner of the riverfront property would have over access to the backlands (Br. for Appellants at 26-27). But all control over ingress and egress over the riverfront tracts was ceded at the time of the Scenic Easement Deed. By petitioners' own reasoning, the value of their 1974 transfer should not include severance damages, since the transferees gained no "leverage" over access to the backlands.

timber management purposes of $45,000.[5] The gist of petitioners' argument is simply that a principal government witness overlooked significant facts in arriving at a valuation figure for the standing timber. Even if wholly valid, therefore, their contention would establish no more than that a trier of fact would have been justified in rejecting the government's evidence in favor of a somewhat higher valuation.

United States v. *Janis, supra*, does not support petitioners' claim. In *Janis*, this Court held that the burden of proof is on the government where the government's case is based solely on "a 'naked' assessment without *any* foundation whatsoever" (428 U.S. at 441) (emphasis in original). In this case petitioners can claim no more than that the government assessment may have been mistaken. As petitioners admit, the government's valuation was based upon an on-site inspection by a professional appraiser, aided by aerial photographs, interviews, and market data (Pet. 3-4). Valuation is "an issue which should be frankly recognized as inherently imprecise * * *. [E]ach case turns on its own particular facts." *Messing* v. *Commissioner*, 48 T.C. 502, 512 (1967). No further review of the valuation dispute in this case is warranted.[6]

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[5]The government's appraiser concluded that the value of the timber on the donated lands was $70,187.31. He discounted that sum by a factor of 45%, to take account of the timber harvesting restrictions in the Scenic Easement Deed and the difficulty of access to the scattered sites. To this sum — $38,500 — the appraiser added $7,000, the agreed value of a tract improved by an abandoned schoolhouse. Pet. App. A12-A13.

[6]Petitioners' reliance on *Coleman* v. *United States*, 704 F.2d 326 (6th Cir. 1983), is misplaced. There, several years after the assessment was made and before trial, both the taxpayers' and the government's records were destroyed. The Sixth Circuit found that the parties had stipulated that the assessment was not based on any evidentiary foundation and concluded, therefore, that the taxpayers had met their burden of showing that the government's assesssment was arbitrary.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

REX E. LEE
Solicitor General

AUGUST 1983

DOJ-1983-08